

DEPARTMENT OF TAXATION

2020 Fiscal Impact Statement

1. **Patron** Jeremy S. McPike

2. **Bill Number** SB 744

House of Origin:

 Introduced

 Substitute

 Engrossed

3. **Committee** Passed House and Senate

4. **Title** Worker Misclassification

Second House:

 In Committee

 Substitute

 X **Enrolled**

5. **Summary/Purpose:**

This bill would provide that, if an individual performs services for an employer for remuneration, that individual shall be considered an employee of the party that pays that remuneration unless such individual or his employer demonstrates that such individual is an independent contractor.

Any employer, or officer or agent of the employer, that fails to properly classify an individual as an employee and fails to pay taxes, benefits, or other contributions required to be paid with respect to an employee would be subject to a civil penalty of up to \$1,000 per misclassified individual for the first offense, up to \$2,500 per misclassified individual for the second offense, and up to \$5,000 per misclassified individual for the third offense or any subsequent offenses.

If the Department of Taxation ("the Department") determines that an employer failed to properly classify an individual as an employee, all public bodies and covered institutions would be prohibited from awarding a contract to such employer or to any firm, corporation, or partnership in which the employer has an interest in for the following time periods:

- Up to one year from the date of the notice for a second offense;
- Up to three years from the date of notice for a third or subsequent offense.

This bill would provide the Tax Commissioner with the authority to work and share information with certain state agencies to identify employers who fail to properly classify individuals as employees. Such agencies would be required to notify the Department if they have reason to believe that an employer has failed to properly classify individuals as employees, and may share any information with the Department that may assist in enforcing the proper classification of employees.

This bill would become effective on January 1, 2021.

This is an Executive Bill.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

8. Fiscal implications:

Administrative Costs

This bill would result in administrative costs to the Department of \$619,200 in Fiscal Year 2021 and \$808,400 in Fiscal Year 2022. No budget amendment is necessary because these costs are assumed in the Introduced Executive Budget.

Revenue Impact

This bill would have a positive General Fund revenue impact of \$1.7 million in Fiscal Year 2021 and \$2.6 million in Fiscal Year 2022. No budget amendment is necessary because this positive revenue impact is assumed in the Introduced Executive Budget.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Inter-Agency Taskforce on Worker Misclassification and Payroll Fraud

In 2018, Governor Northam issued Executive Order 16, which directed the reconstitution of the Interagency Taskforce and requested updated recommendations on how to measure and combat misclassification in Virginia.

In 2019, the Governor issued a new order, Executive Order 38, which directed the Taskforce to produce a written report with recommendations ahead of the 2020 Session. The Taskforce made several recommendations in its report including, but not limited to:

- Penalize misclassification sufficiently so as to deter this activity.
- That penalties apply even when an employer receives advice, consultation, or counsel to engage in worker misclassification as part of its business model.
- That legislation provides for a private cause of action against an employer for recovery of damages for misclassification to include wages, taxes, and value of benefits lost, and attorney's fees.
- That legislation provides "whistleblower protection" for those who report suspected misclassification or other workplace fraud.
- That bidders be debarred for graduated periods of time, based upon repetition or severity of violations, from bidding on and receiving awards of contracts under the Virginia Public Procurement Act when the bidder is found to have violated requirement of proper worker classification.
- Require certain state agencies to undertake specific workplace fraud and misclassification investigations in a joint fashion to gather evidence for enforcement actions, and that the Taskforce continue to help develop inter-agency cooperation and the exchange of information, and to help develop procedures and processes to streamline misclassification, payroll fraud, and wage theft claims.

- An agency be identified and given authority to lead the effort against worker misclassification.

Misclassification and Wage Theft Taskforce

In 2014, Governor McAuliffe issued Executive Order 24 forming a Misclassification and Wage Theft Taskforce and directing that a report with recommendations be submitted no later than December 2014. Based on taskforce recommendations, several combined enforcement actions were conducted at Northern Virginia and Hampton Roads worksites.

JLARC Review of Employee Misclassification in Virginia

During the 2011 Session, the General Assembly enacted a joint resolution that directed the JLARC to study misclassification of employees as independent contractors in Virginia. In JLARC's 2012 report regarding the study, it found that:

- Employers who properly classify workers pay higher payroll costs and may be less competitive in their respective industries than employers who misclassify. In addition, misclassified workers are often denied a variety of legal rights and benefits.
- A Virginia Employment Commission ("VEC") audit of one percent of Virginia employers found that 5,639 workers were misclassified in 2010. Based on findings in other states, Virginia may have on the order of 40,000 misclassifying employers and 214,000 misclassified workers.
- Worker misclassification lowers Virginia's income tax collections, leading to estimated foregone revenues on the order of \$1 million for workers identified during VEC audits. VEC and the Virginia Workers' Compensation Commission may also forego revenue as a result of misclassification, but local government revenues are not affected.

JLARC recommended that:

- The Governor establish an interagency task force on employee misclassification. JLARC recommended.
- The General Assembly consider amending the *Code of Virginia* to make misclassification of employees illegal, and to specify financial penalties for employers who misclassify workers.
- The General Assembly consider amending the *Code of Virginia* to authorize a stop work order to be issued to employers working on state contracts who are misclassifying workers. In addition, penalties may include disbarment of the employer from bidding on any future state or local contracts for a specified period of time.

During the 2013 Session, the General Assembly considered, but did not enact, legislation that would have established an interagency task force.

Proposed Legislation

This bill would provide that if an individual performs services for an employer for remuneration, that individual shall be considered an employee of the party that pays that remuneration unless such individual or his employer demonstrates that such individual is an independent contractor. The Department would be required to make its determination using the IRS's guidelines to determine whether a worker is an employee or an independent

contractor with respect to their employer. This is intended to test the degree behavioral and financial control between the worker and the employer and the relationship between both parties. The Department would be required to enforce these provisions in conjunction with its enforcement of withholding tax.

Any employer, or officer or agent of the employer, that fails to properly classify an individual as an employee and fails to pay taxes, benefits, or other contributions required to be paid with respect to an employee would be subject to a civil penalty of up to \$1,000 per misclassified individual for the first offense, up to \$2,500 per misclassified individual for the second offense, and up to \$5,000 per misclassified individual for the third offense or any subsequent offenses. Each civil penalty paid pursuant to this bill would be paid into the General Fund. For purposes of this bill, all occurrences of misclassification of employees made by the same employer at the same time, or within 72 hours, would be deemed to be a single offense.

If the Department determines that an employer failed to properly classify an individual as an employee it would be required to notify all public bodies and covered institutions, including all counties, cities, school divisions, and towns having a population greater than 3,500 in Virginia, of the name of the employer. Upon an employer's subsequent violations of the rules regarding the classification of employees, all such public bodies and covered institutions would be prohibited from awarding a contract to such employer or to any firm, corporation, or partnership in which the employer has an interest in for the following time periods:

- Up to one year from the date of the notice for a second offense;
- Up to three years from the date of notice for a third or subsequent offense.

In addition, a prospective contractor would be debarred from contracting with all public bodies and covered institutions whenever the Tax Commissioner determines that it has committed more than violation of the rule regarding the classification of employees.

"Covered institution" would be defined as a public institution of higher education operating:

- Subject to a management agreement;
- Under a memorandum of understanding; or
- Under the pilot program authorized in the Governor's Introduced Executive Budget.

No person would be permitted to require or request that an individual enter into an agreement or sign a document that results in the misclassification of the individual as an independent contractor or otherwise does not accurately reflect the relationship with the employer. It would also be unlawful for an employer or any other party to discriminate in any manner or take adverse action against any person in retaliation for exercising rights protected under this bill.

This bill would provide the Tax Commissioner with the authority to work and share information with the Department of Labor and Industry, the VEC, the Department of Small Business and Supplier Diversity, the Department of General Services, the Workers' Compensation Commission, and the Department of Professional and Occupational Regulation to identify employers who fail to properly classify individuals as employees. Such agencies would be required to notify the Department if they have reason to believe that an employer has failed to properly classify individuals as employees, and may share any information with the Department that may assist in enforcing the proper classification of employees.

This bill would allow any person aggrieved by an action by the Department with respect to a debarment to apply for relief to the Tax Commissioner. In addition, this bill would provide such person to apply to a circuit court for relief.

The Department would be required to report annually on its enforcement of the measures set forth in this bill to the Governor and the General Assembly. The Department's report would be required to include:

- Information regarding the number of investigated reports of worker misclassification;
- The findings of such reports;
- The amount of combined tax, interest, and fines collected;
- The number of referrals to the Department of Labor and Industry, Virginia Employment Commission, Department of Small Business and Supplier Diversity, Workers' Compensation Commission, and Department of Professional and Occupational Regulation; and
- The number of notifications of failure to properly classify to all public bodies and institutions.

The Department would also be required to develop guidelines, exempt from the Administrative Process Act, implementing the provisions of this bill.

This bill would become effective on January 1, 2021.

Similar Bills

House Bill 1407 is substantially similar to this bill, except that it would require debarment for up to two years for violating the rules regarding the classification of employees three or more times.

cc : Secretary of Finance

Date: 3/11/2020 MTH
SB744FER161